

Service Date: March 18, 1986

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

IN THE MATTER Of The Application) UTILITY DIVISION
Of PACIFIC POWER AND LIGHT COMPANY)
For Authority to Adopt New Rates) DOCKET NO. 84.7.38
And Charges For Electric Service)
Furnished in the State Of Montana.) ORDER NO. 5128b

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ORDER AFTER REHEARING

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APPEARANCES

FOR THE APPLICANT:

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97204.

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and Phillips, One Main Building, Kalispell, Montana 59901.

FOR THE MONTANA CONSUMER COUNSEL:

James C. Paine, Montana Consumer Counsel, 34 West Sixth
Avenue, Helena, Montana 59620.

FOR THE MONTANA CONSUMER COUNSEL:

Tim Baker, Staff Attorney, 2701 Prospect Avenue, Helena,
Montana 59620.

BEFORE:

HOWARD L. ELLIS, Commissioner, Presiding
CLYDE JARVIS, Chairman
JOHN B. DRISCOLL, Commissioner
TOM MONAHAN, Commissioner

FINDINGS OF FACT

1. On April 22, 1985, the Commission approved Order No.

5128, which disposed of all matters then pending in Docket No. 84.7.38.

2. On May 28, 1985, the Commission approved Order No. 5128a, which disposed of all remaining matters pending in Docket No. 84.7.38. In that Order, the Commission granted the motion of Montana Consumer Counsel (MCC) to rehear the issue of whether or not to include Colstrip 3 in rate base because of a late filed exhibit of Pacific Power and Light Company (PP&L, Company, or Applicant). That exhibit was an analysis of the net present value to ratepayers if Colstrip 3 were included in the Company's rate base and the benefits of the Black Hills sales contract were flowed through to ratepayers.

3. Subsequently, a procedural schedule was established which included dates for discovery, testimony, and a hearing. Mr. David Peterson submitted testimony on behalf of MCC. Messrs. Tim Watson and Dennis Steinberg provided testimony for PP&L. The hearing was held on November 14, 1985, in Kalispell, Montana.

MCC

4. In his testimony, Mr. Peterson of MCC provided a brief history of the results of the Company's proposed Net Benefits Analysis (NBA). The NBA, as originally submitted in PP&L's late filed exhibit, showed a maximum net benefit of \$29.2 million using MCC's proposed capital structure and a minimum net benefit of \$21.9 million using PP&L's proposed capital structure. In response to an MCC data request, the Company provided a revised NBA to reflect the Commission's authorized 11.24 percent rate of return and its determination of Colstrip 3 production, transmission, and common investment. With those modifications, the revised NBA showed a net

benefit of \$15.0 million. (MCC Exh. 1R, p. 5)

5. Mr. Peterson testified that it is inappropriate to compare revenues received under the Black Hills contract with Colstrip 3 costs because PP&L has an obligation to honor the agreement with Black Hills regardless of the production of -, Colstrip 3 (MCC Exh. 1R, p. 7). He stated, "The appropriate test for rate base inclusion involves a determination of whether the additional investment is necessary to provide adequate and reliable service to current customers consistent with least cost objectives. ...Pacific has not met the need or "used and useful" test and the Colstrip-Black Hills transactions should be excluded from rates." (MCC Exh. 1R, p. 16)

6. Mr. Peterson also expressed concerns that, assuming the alleged net benefit can actually be achieved over the life of the Black Hills contract, current Montana customers would not be PP&L's customers long enough to realize any of the benefits. (MCC Exh. 1R, pp. 16-17)

7. Mr. Peterson presented several possible areas where the NBA may have been flawed. Among them was an argument that the NBA failed to include capital costs associated with the additional 5 MW of capacity required to service Black Hills' 75 MW entitlement. The root of this concern is that the Company is required to commit 75 MW of firm capacity to Black Hills, but PP&L's share of Colstrip 3 is only 70 MW. As a result, PP&L must provide an additional 5MW of capacity, and Peterson contends that the cost of that additional capacity should be, but was not, included in the NBA. At MCC's request, the Company quantified the effect of reflecting that additional 5 MW of capacity in the NBA. The result of reflecting those additional capital costs reduced the net

benefits by \$400,000 from \$15.0 to \$14.6 million. (MCC Exh. 1R, pp. 10-11, 17)

8. Another of Mr. Peterson's concerns with the mechanics of the NBA was the use of the Company's approved rate of return of 11.24 percent as the discount rate. He stated, "The appropriate discount rate is one that more closely approximates the ratepayers' cost of capital rather than Pacific's cost of capital" (MCC Exh. 1R, p. 13). Peterson contended that the ratepayers' cost of capital is much higher than PP&L's. The effect on the NBA of increasing the discount rate to reflect the consumers' cost of capital was a gradual reduction of net benefits. In fact, Peterson calculated that at a discount rate of 14.56 percent the benefits would be completely eliminated. (MCC Exh. 1R, pp. 13-15, 17)

9. Based on his analysis of this entire issue, Mr. Peterson concluded, "Therefore, the life cycle analysis (NBA) fails to provide any reasonable basis to depart from the rate making treatment to exclude Colstrip Unit 3 from rate base adopted by the Commission in Docket No. 83.10.71." (MCC Exh. 1R, p.- 17)

PP&L

10. PP&L rebutted the testimony of MCC witness Peterson with the testimony of Messrs. Tim Watson (PP&L Exh.- 2R) and Dennis Steinberg (PP&L Exhs. 3R and 4R).

11. Mr. Watson addressed some of the policy implications of Mr. Peterson's recommendations and the appropriate discount rate to be used in the NBA. Concerning the issue of net benefits being enjoyed by future versus current customers, Watson stated that it is not particularly meaningful to make

the distinction. He testified, "In large measure they are the same individuals because 3 years, 10 years, 20 years, and 40 years from now, over 97 percent, 88 percent, 78 percent and 57 percent of Pacific's existing Montana customers, respectively, will be future customers" (PP&L Exh. 2R, p. 7).

12. Concerning the proper discount rate to be used in the NBA, Mr. Watson disagreed with Mr. Peterson's contention that a discount rate higher than 11.24 percent should be used to reflect perceived consumer capital costs. He said that Peterson's data is based on short-run consumer borrowing rates and are, therefore, inappropriate for evaluating a long-run investment such as a 35-year coal fired power plant. (PP&L Exh. 2R, p. 8-9)

13. Mr. Steinberg addressed Mr. Peterson's other concerns about the NBA. Concerning the 5 MW difference between the Company's ultimate 75 MW capacity obligation to Black Hills and its 70 MW share of Colstrip 3 resulting in a reduction of net benefits of \$400,000, Steinberg disagreed with Peterson's contentions. He stated, "Mr. Peterson failed to include in his hypothesis the fact that if Black Hills requests additional capacity they must also pay for any additional capacity" (PP&L Exh. 3R, p.2). Steinberg calculated that the effect of including the revenue received by the Company from Black Hills under this scenario would actually be higher than the downward adjustment of \$400,000 discussed by Mr. Peterson, resulting in higher customer net benefits. (PP&L Exh. 3R, pp. 2-3)

14. Concerning the NBA, Mr. Steinberg concluded, "I believe that the \$15-\$28 million range of net benefits fairly reflects the advantage to Pacific's Montana customers of including both Colstrip Unit 3 and the Black Hills sale in

the rate making process over the term of the Agreement."
(PP&L Exh. 3R, p. 9)

COMMISSION ANALYSIS

15. The NBA, brought into this Docket through a late-filed exhibit, presented the Commission with a unique and controversial approach in analyzing the question of whether or not to include Colstrip 3 in PP&L's rate base and flow through the effects of the Black Hills sales contract. The Commission granted MCC's request for a rehearing on the NBA so that the issue could be thoroughly examined. The testimony of both parties has been very enlightening concerning the sundry technical and policy aspects, as well as the ramifications of the NBA. It has provided the Commission with a clear and prudent solution to handle this issue to the benefit of all parties and their constituents - ratepayers and stockholders.

16. Concerning Mr. Peterson's argument that the NBA is an improper method in determining the appropriateness of including Colstrip 3 in the Company's rate base, the Commission PP&L Docket No. 84.7.38, Order No. 5128b 6 ~ disagrees. In Docket No. 83.10.71, Order No. 5028c, the Commission disallowed Colstrip 3 from PP&L's rate base and also allowed the benefits from the Black Hills contract to flow to the Company's stockholders as partial recovery of the Colstrip 3 investment. In Docket No. 84.7.38, the Commission was presented with the NBA which purported to show that the recognition of Colstrip 3 and the Black Hills contract for rate making purposes would result in positive net benefits for the Montana ratepayers. The Commission believes it would be improper not to allow ratepayers to realize these benefits.

17. The Commission rejects MCC's concern that current ratepayers may not be PP&L's customers long enough to realize any of the benefits. In his rebuttal testimony, Mr. Watson provided very convincing statistics that PP&L's customers remain relatively constant over time (e.g.: 10 years from now 88 percent of the Company's existing Montana customers will be future customers.), so that the vast majority of the Company's Montana customers will indeed realize the benefits. The Commission is very sensitive about this issue and faces it quite often (e.g.: every time there is a rebate or some other instance of timing, such as effective dates of tariffs). Obviously the migration of ratepayers over time will result in some seeing only disbenefits while others will see only benefits. This phenomenon, however, to a large extent can not be controlled. The Commission, in its decisions, makes every effort to prevent this from becoming a large, negative factor.

18. Concerning Mr. Peterson's various allegations that the NBA is faulty in some of its assumptions and data input, the Commission agrees with MCC that the results of this analysis are quite sensitive to the parameters and data installed in the model. That is why the Commission's decision below is very careful in properly viewing the NBA. For instance, Mr. Peterson raised some questions about including in the NBA the capital costs for the additional 5 MW of capacity needed to fully serve the Black Hills contract requirements. He also expressed disagreement with the Company's choice of discount rate. The Commission's decision is structured so that these and other concerns are quelled to the benefit of all parties.

19. Based on the discussions in the above Findings of Fact, the Commission makes the following determinations:

a). Colstrip 3 remains in PP&L's rate base and the Black Hills contract continues to be reflected for rate making purposes as an above-the-line item.;

b). PP&L must file future rate cases reflecting the \$15.0 million net benefits, as proposed and supported by the testimony of the Company's witnesses, as a floor (That is, amounts below this floor must be charged to PP&L's stockholders.);

c). Any net benefits exceeding \$15.0 million must be reflected by a 50 percent/50 percent sharing between ratepayers and stockholders;

d). PP&L will include the effects of the NBA in its firm sales normalization adjustment per rate filing;

e). PP&L must evaluate the relevant portions of its current filing, Docket No. 85.10.41, to determine whether or not the Company is in compliance with the requirements of the Commission's findings in this Order, and the Company must report the results of such evaluation to the Commission and MCC, including work papers, by April 1, 1986.

20. Much of the basis for the Commission's decision concerning the proper method of handling this matter centers around the fact that PP&L seemed quite confident in the validity of its proposed NBA. The Company's adamant support of the NBA convinced the Commission that PP&L should be willing to stand behind its analysis; therefore, the setting of a reasonable floor of net benefits to be passed through to ratepayers seemed proper. As mentioned in above Findings of Fact, based on the Commission's findings in Order Nos. 5128 and 5128a, the Company refined the NBA to show positive net

benefits of \$15.0 million. Mr. Peterson testified that the net benefits could be \$14.6 million or less. In his rebuttal testimony, Mr. Steinberg of PP&L strongly rebutted Mr. Peterson and stated that the range of net benefits is between \$15 and \$28 million. The Commission fully agrees with MCC that the NBA is highly volatile depending on its data input. However, the Company has repeatedly stated that a net benefit of \$15.0 million exists for the ratepayers when Colstrip 3 and the Black Hills contract are given above-the-line treatment, and the Commission feels compelled to allow the ratepayers to reap that benefit. Therefore, the floor, or minimum net benefits, of \$15.0 million is a fair determination.

21. The record indicates that a 50 percent/50 percent sharing between ratepayers and stockholders for any net benefits exceeding the \$15.0 million floor is proper. Mr. Watson of PP&L testified during cross-examination by Mr. Baker, Commission Staff attorney:

Q And you understand that this treatment would also include a floor level so to speak of net benefits based upon a further negotiation by using the company's and MCC's figures presented here at starting point?

A Yes, a floor could be established. I might also add that there should be a zone of reasonableness and that anything that we do that beats what we thought that we could do there could be a sharing. Anything that's below what we thought we could do, given the way that I've seen regulations work in the past, I imagine there would be a hundred percent sharing of our stock holders; they would probably bite the bullet on that. That's not unacceptable to me, just so that I have some opportunity for some up side gain with maybe a 50/50 sharing

of that up side gain with the customers.

(TR, p. 29)

The sharing provides a benefit for both ratepayers and stockholders. The Company is provided with the incentive to maximize profits for its stockholders, and the ratepayers prosper by being credited with half of any net benefits exceeding the floor of \$15.0 million achieved by PP&L through aggressive efforts to maximize its profits while operating efficiently.

22. Concerning the use of the firm sales normalization adjustment as the mechanism to flow through the benefits of the NBA and any benefits exceeding the floor, Mr. Steinberg of PP&L, under the cross-examination of Commission Staff attorney Baker, testified:

Q Now, in discussing or in proposing a net benefits floor with Mr. Watson, do you think that Pacific would object to including the firm sales adjustment in the life cycle analysis for the purpose of establishing that floor?

A I would like to give the whole idea of the floor a lot more consideration than I have to date. But I would just say that up to now inclusion or utilization of the firm sales normalization adjustment by Pacific has been a standard operating practice in Montana. In past rate cases we've disputed the proprietaries ~sic] of that adjustment but we have not prevailed and we have been using that adjustment. That's not to say in the future events might change but I would think certainly that that part of the process would be important, the recognition of the extra benefits of Black Hills and Colstrip in the firm sales normalization adjustment, yes. (TR, p.62)

In viewing the firm sales normalization adjustment as the proper mechanism to reflect all net benefits, the Commission cautions PP&L that the Company will be responsible for making sure that all benefits are dutifully flowed through to its Montana ratepayers, regardless of its case-by-case stance on the propriety of the firm sales normalization adjustment.

23. In all relevant subsequent filings (including Docket No. 85.10.41, as discussed in Finding of Fact No. 19), PP&L must provide work papers which present a detailed explanation of the effect of the NBA on that particular rate case (in terms of revenue requirement, etc.). These Work papers should specify data concerning the floor of benefits, amounts below the floor which are to be charged 100 percent to PP&L's stockholders, and amounts of benefits above the floor which are to be shared equal between ratepayers and stockholders. Also, in each filing, the Company should provide work papers and charts showing yearly running totals of these benefits passed through to the Montana ratepayers, in compliance with the Commission findings et forth in this Order.

24. In summary, the Commission believes that this Order best serves the interests of all parties. The Company is allowed to continue to include Colstrip 3 in rate base and to share equally the net benefits exceeding the floor. The ratepayers are guaranteed a \$15.0 million benefit over the term of the Black Hills contract and an equal sharing of all net benefits above the floor. Ratepayers are given added protection of actually realizing the benefits by the requirement that PP&L provide related work papers with each rate filing.

CONCLUSIONS OF LAW

1. The Applicant, Pacific Power and Light Company, furnishes electric service to consumers in Montana, and is a "public utility" under the regulatory jurisdiction of the Montana Public Service Commission. 69-3-101, MCA.

2. The Commission properly exercises jurisdiction over the Applicant's rates and operations. 69-3-102, MCA and Title 69, Chapter 3, Part 3, MCA.

3. The Commission has provided adequate public notice of all proceedings and opportunity to be heard to all interested parties in this Docket. Title 2, Chapter 4, MCA.

ORDER

1. The Pacific Power and Light Company shall comply with the Commission determinations set forth in this Order, especially those delineated in Finding of Fact No. 19.

2. All motions and objections not ruled upon are denied.

DONE AND DATED this 17th day of March, 1986, by a 4 - 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

Clyde Jarvis, Chairman

Howard L. Ellis, Commissioner

John B. Driscoll, Commissioner

Tom Monahan, Commissioner

ATTEST:

Trenna Scoffield
Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.